WILSHIRE CONSULTING

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April 28, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: High Yield Manager Contract Renewal Recommendation[1]

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendation regarding the annual review and renewal of the contracts of the two remaining high yield managers.

Recommendation

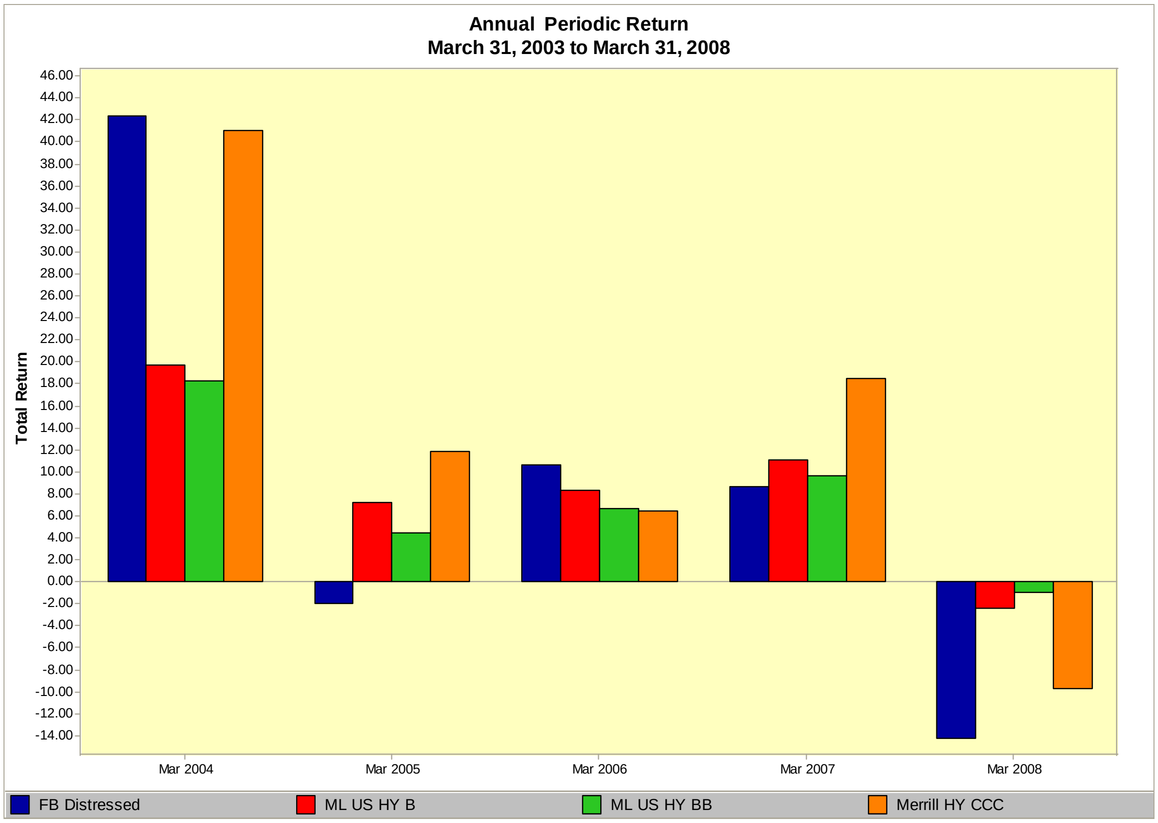
Wilshire recommends that the Investment Committee renew the contracts of both Nomura and PIMCO. Wilshire will comment on Highland Capital Management in the Closed Session External Manager Update.

Market Performance

The effects of the credit crunch were felt throughout the fixed income universe as there was a general flight to quality over the past twelve months. The high yield market suffered negative returns during the 12 month period ending March 31, 2008. Reversing the trend from last year, higher-quality high yield securities outperformed lower-quality high yield securities (when judged on one-year performance cycles ending on March 31) exhibiting the flight to quality – even within the high yield market. As you can see on Figure 1, lower-quality (i.e. CCC-rated) securities significantly outperformed higher-quality (i.e. BB-rated) securities in the 12 month periods ending March 31, 2004, 2005 and 2007.

[1] Wilshire's Code of Conduct requires us to disclose that certain of these managers are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for services rendered. The names of CalPERS High Yield managers that are clients of Wilshire will arrive in a separate letter, in accordance with our Code of Conduct.

Figure 1



Additionally, the leveraged loan market (below investment grade bank loans) experienced markedly poor performance, primarily due to technical factors. The Credit Suisse Leverage Loan Index lost 14.25% over the past twelve months. Bank loans, which are senior to bonds in a company's capital structure, were used by many investors to create CLOs (collateralized loan obligations). There are two basic types of CLOs – market value CLOs and cash flow CLOs. Market value CLOs lever the underlying bank loans based on the equity contributed to the CLO, but must meet margin calls based on any decline in the market value of the bank loans. As loans began to fall in value, many market value CLOs were forced to meet margin calls by selling bank loans, creating additional pressure on bank loan prices. These lower prices forced additional margin calls, resulting in additional portfolio liquidations – thereby creating a vicious cycle. Figure 2 shows the average bid price for leveraged loans for the S&P/LSTA Leveraged Loan Index. Note the dramatic decline in loan prices in late 2007 and early 2008.

Figure 2

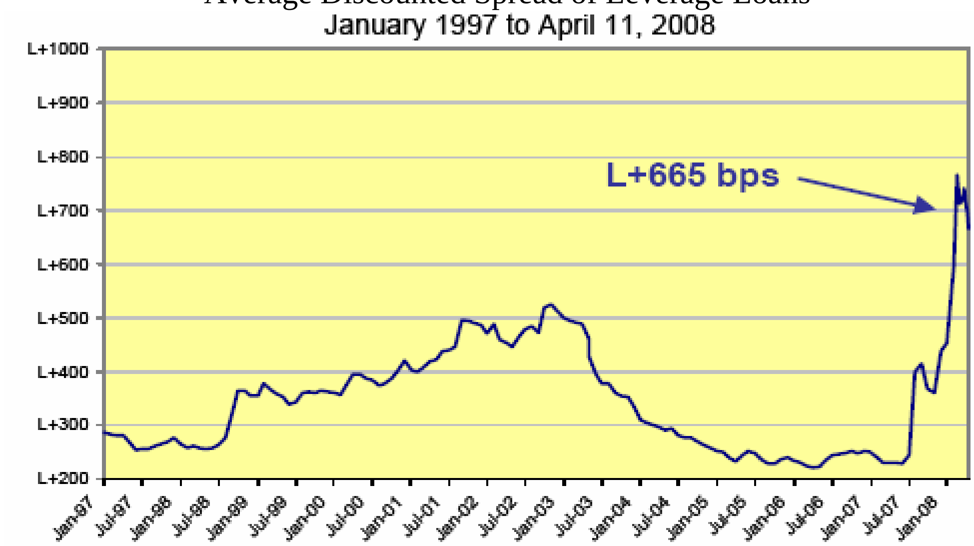
Average Bid Price of Leveraged Loans

Source: ING Talking Points, April 17, 2008

Of course, declining loan prices leads to opportunities. Figure 3 shows the average discounted spread to LIBOR for leveraged loans. The precipitous decline in prices has lead to a correspondingly more attractive yield.

Figure 3

Average Discounted Spread of Leverage Loans

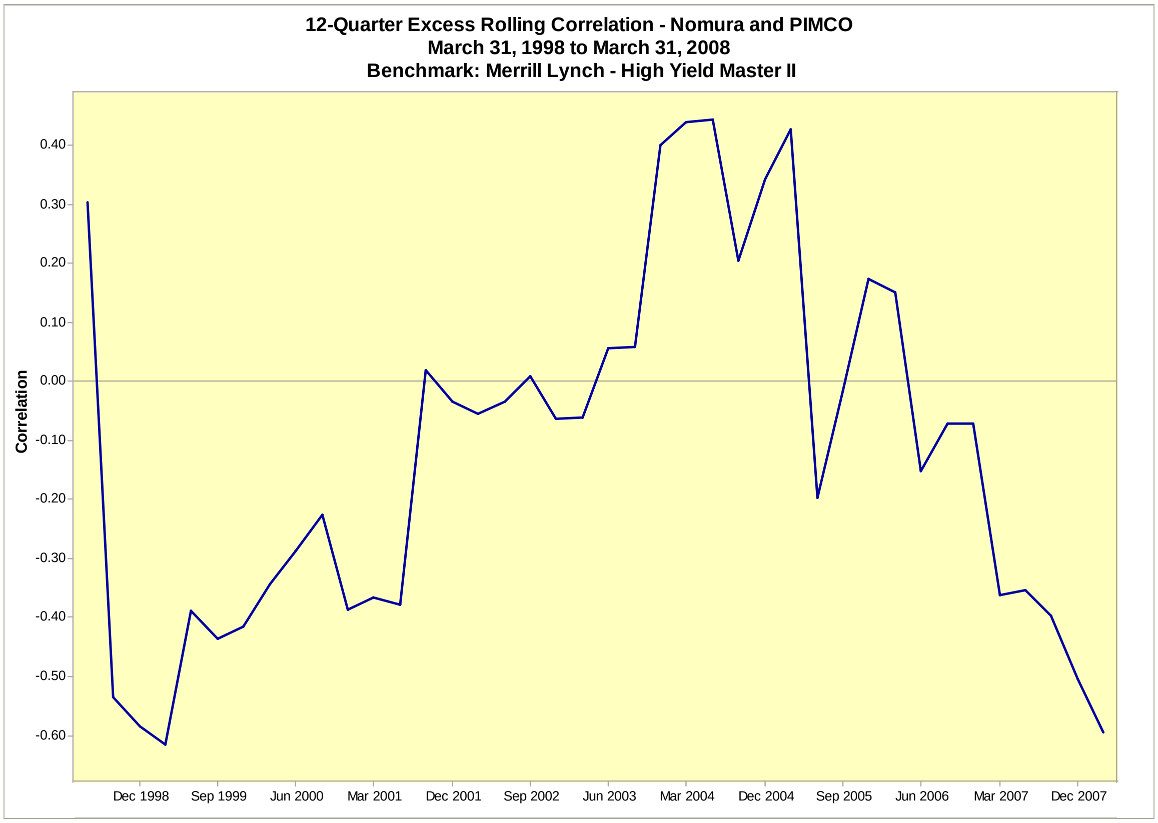


Source: ING Talking Points, April 17, 2008

Manager Contract Renewals

We support the annual contract renewal recommendation for both managers as we believe each manager has a strong process that has added value over the long term. Furthermore, we believe that the investment approach of each of the providers plays a unique role in the CalPERS high yield portfolio and that their investment management styles are complementary. Figure 4 shows the rolling three year correlation of excess returns between PIMCO and Nomura. Note that the correlation is currently as low as it has been over the past ten years, meaning that PIMCO and Nomura are effectively diversifying each other.

Figure 4



Additionally, since CalPERS has the option of terminating either of these managers on thirty days notice, upon any unanticipated negative change in the portfolio management team, the process, or the firm, or for any other reason, CalPERS may terminate any of these managers on short notice.

Below are discussions on each of the two current providers.

Nomura

Nomura is a bottom-up manager focused on companies with improving fundamental characteristics. Nomura's bottom-up process leads it to conduct field research by meeting with company management and doing on-site visits. Nomura underperformed the benchmark for the year ended March 31, 2007 and has slightly lagged its index (24 basis points annualized) since the inception of the account. Wilshire continues to believe in this manager's ability to add value to the high yield program and will continue to monitor the portfolio and its performance.

PIMCO

PIMCO manages a very broadly diversified portfolio which limits the effect (positive or negative) that any single issue can have on the portfolio. PIMCO has strong non-traditional support for its high yield effort from its emerging markets and non-dollar teams. PIMCO's portfolio slightly outperformed over the past year and since inception (31 basis points annualized). Wilshire believes PIMCO has demonstrated the ability to add value to the high yield program and will continue to monitor the portfolio and its performance.

Conclusion

Wilshire concurs with Staff's recommendation to renew the contracts for both of the high yield managers, as CalPERS still has the right to terminate on 30 days notice. Wilshire will continue to monitor these managers over the coming months. Additionally, Wilshire is working with Staff on the current RFP for additional managers of below-investment grade fixed income and will strive to find complementary managers who can add value over the long term.

If you have any questions or comments, please let me know.

Sincerely,